

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Agriculture Committee Analyst: Colin Stevens Bill Number: AB 1641

Related Bills: AB 1513 (1998) Telephone: 845-3036 Introduced Date: 3/4/99

Attorney: Doug Bramhall Sponsor: \_\_\_\_\_

**SUBJECT:** Agricultural Prunings Delivered to Biomass Conversion Facility Credit

### SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to \$30 for each ton of agricultural prunings grown in California and delivered without charge to a biomass facility in a form suitable for biomass conversion. The credit would be certified by the Department of Food and Agriculture (DFA) and allowed only to the grower of the agricultural prunings.

### EFFECTIVE DATE

This bill would apply to taxable or income years beginning on or after January 1, 1999, and before January 1, 2009.

### BACKGROUND

Biomass is a renewable energy resource in which wood products, crop residues, and lawn and garden clippings are burned in order to reduce waste and produce heat and energy. According to staff from the California Energy Commission, both federal and state laws contain provisions encouraging the production of electricity through biomass. However, the cost of biomass electricity production is significantly higher than the cost of other methods of generating electricity (between 7 and 13 cents per kilowatt hour for biomass, as compared to a current price for electricity from natural gas-fired plants of 4 to 5 cents per kilowatt hour). To operate, biomass plants must have a continuous supply of material to burn, including forest, agricultural and urban wood waste. Biomass plants can contribute to improved air quality since fewer wood products or waste products are burned in the open or sent to landfills.

According to staff from the Energy Commission, a portion of the \$540 million state fund for energy restructuring known as the Energy Resources Programs Account (ERPA) is projected for allocation to support renewable resources. AB 1890 (Ch. 854, Stats. 1996) provided utility restructuring subaccounts to fund specified energy generation technologies, such as solar and biomass, whose development is considered to be in the public interest. Under current law, ERPA will be funded until December 31, 2001.

According to staff from the DFA, that department does not have a regulation defining agricultural prunings and would have to promulgate a regulation in order to implement this bill. However, staff indicated agricultural prunings typically would include prunings from fruit and nut trees.

### Board Position:

<u>      </u> S	<u>      </u> NA	<u>      </u> NP
<u>      </u> SA	<u>      </u> O	<u>      </u> NAR
<u>      </u> N	<u>      </u> OUA	<u>  X  </u> PENDING

Department Director

Date

**Gerald Goldberg**

**4/16/1999**

## SPECIFIC FINDINGS

**Federal law and state laws** contain a variety of provisions specifically relating to farmers and agriculture. These provisions include special accounting and inventory methods, certain income deferral conditions, capital gain-ordinary loss treatment, the current deduction of items normally required to be capitalized, and exempt status for labor, agricultural, or horticultural organizations.

**Existing federal and state laws** provide various tax credits that are designed to provide tax relief for taxpayers who incur certain expenses or to influence behavior, including business practices and decisions (e.g., research credits, enterprise zone or program area hiring credits). These credits provide incentives for businesses to perform actions that they may not otherwise do, may not do at the desired location, etc.

**Existing state law** provides general rules that apply to the division of credits when multiple taxpayers, including partnerships, share in the costs used as the basis of the credit. These rules apply unless an individual credit specifies different rules.

Except as specified, **state law** does not allow any tax credit to reduce regular tax below the tentative minimum tax for purposes of the alternative minimum tax (AMT) calculation.

**This bill** would create a tax credit equal to \$30 for each ton of agricultural prunings, as defined by DFA regulation, grown in California and delivered without charge to a facility for biomass conversion, in a form suitable for biomass conversion at the facility. The credit would be allowed only to the grower of the prunings.

For purposes of this bill, "grower" would mean the owner or operator of an agricultural facility that produces prunings in the normal course of producing agricultural products. An owner-operator of a facility for biomass conversion could not be considered a grower for any purposes of this bill. An owner-operator would not be allowed any other tax credit for the prunings for which a tax credit is allowed under this section.

For purposes of this bill, biomass conversion is as defined in Section 40106 of the Public Resources Code, which provides that biomass conversion is the controlled combustion, when separated from other solid waste and used for producing electricity or heat, of the following:

- agricultural crop residues;
- bark, lawn and yard and garden clippings;
- leaves, silvicultural residue and tree and brush pruning; and
- wood, wood chips and wood waste.

This bill would require that the DFA:

- obtain the taxpayer's identification number, including those of individual partners and S corporation shareholders;
- certify the delivery of the prunings in a form usable for biomass conversion to the facility;

- issue the certificate to the taxpayer and provide the taxpayer with a copy of the certification to retain for his or her records; and
- provide an annual listing to the Franchise Tax Board (FTB) of taxpayers issued certificates and of the tonnage of prunings delivered by each taxpayer.

Taxpayers claiming this credit would be required to:

- Provide the DFA with documents and other information deemed necessary to verify that prunings meet specified requirements;
- Retain a copy of the certificate issued by the DFA and provide it to the FTB upon request; and
- Provide the DFA with taxpayer identification numbers required to issue certificates.

**This bill** would provide that if a taxpayer's allowable credit could not be used in any given year, the excess credit could be carried over for up to ten years or until exhausted, whichever occurs first.

The general rules regarding the division of credits would apply, and this credit would not reduce regular tax below the tentative minimum tax for AMT purposes.

#### Policy Considerations

While tax incentives may be given to influence behavior to achieve a desired social benefit, credits typically are based on some portion of an expense. This credit would not determine the amount of the credit by reference to actual costs incurred.

#### Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

According to DFA staff, that department would need to adopt regulations defining agricultural prunings before this bill could be implemented. The process of adopting regulations could create a delay between the time the bill is enacted and the time it could be implemented.

#### Technical Considerations

The credit under the PITL lacks a portion of one sentence. Amendment 1 would add this portion so that the law is identical under the PITL and the B&CTL.

The definition of "grower" includes both an "owner" and an "operator" of an agricultural facility. If the owner of an agricultural facility is not also the operator of that facility, it is arguable that both the owner and operator, under the terms of this bill, would be entitled to the credit. The authors may wish to clarify their intent with respect to which of these two parties is to receive the credit if the owner is not also the operator.

## REGULATIONS

According to DFA staff, that department would need to adopt regulations defining agricultural prunings before this bill could be implemented.

## FISCAL IMPACT

### Departmental Costs

This bill would not significantly impact the department's costs.

### Tax Revenue Estimate

Pending Based on the data and assumptions discussed below, revenue losses from this measure are estimated as follows:

Revenue Impact of <b>AB 1641</b> - As Introduced March 4, 1999 Enactment Assumed After 6/30/99 (In \$Millions)			
Fiscal Years	1999-00	2000-01	2001-02
Revenue Impact (Rounded)	<b>minor</b>	<b>(1)</b>	<b>(1)</b>

Minor loss is less than \$500,000

This estimate does not account for any changes in employment, personal income, or gross state product that might result from this bill.

### Tax Revenue Discussion

The revenue impact of this proposal will depend on the amount of qualified agricultural prunings delivered in a suitable form to biomass facilities as certified by the Department of Food and Agriculture and the tax liabilities of affected taxpayers.

The estimated impact of this proposal was determined in the following steps:

- ◆ The California Biomass Energy Alliance survey in 1996 indicated that about 7 million tons of wastes were burnt in California biomass plants that year.
- ◆ According to data from the California Environmental Protection Agency report from February 1997 ("*Cost Shifting Strategies for the Biomass Power Industry*"), the biomass power industry burns fuel that originates from three sources: forest wastes (mill waste and in-forest residue), urban wood wastes (construction and demolition debris, pallets, and wood from park and street maintenance), and agricultural wastes (rice hulls and straw, orchard prunings, manure, and other).
- ◆ The same report presented the distribution of fuel type consumed by California biomass facilities during the year 1993: 60% of fuel was originated from forest residue, 21% from urban wastes, and 19% from agriculture wastes. The 19% rate was applied to the total fuel consumption in 1996, which yields 1,330,000 bone dry tons (BDT) of agriculture wastes burnt in that year.

- ◆ According to information from the California Biomass Energy Alliance, it was estimated that orchard prunings do not exceed 15% of agricultural fuel. This yields less than 200,000 BDT of orchard prunings per year.
- ◆ The California Integrated Waste Management Board estimated that the average transportation cost would be \$5 per ton of chips for loading and \$15 per ton in transportation for a 50-mile distance. Additional fuel expenses, capital, and labor costs would occur during pruning collection and chipping. The average total expenses would be close to the \$30 per ton, if not higher.
- ◆ Currently California growers generally eliminate annual prunings by burning them in the field or by contracting with about 200 companies for the collection of prunings, their chipping, and delivery to the biomass facilities. Growers deliver directly to biomass facilities in very limited amounts. Given the associated costs of delivering prunings to a biomass facility and the fact that under the bill the biomass facility cannot be charged, it was assumed that perhaps 10% of growers would meet this bill's requirements and apply for the credit. This projection also allows for the fact that over 40% of California farms do not report positive taxable incomes for the year (according to departmental data).
- ◆ Based on discussions with staff at the Department of Food and Agriculture, it is assumed that implementation by that department would not begin until late 1999 or early in 2000.

With a deduction offset applied, revenue losses would be on the order of \$1 million annually ( $200,000 \text{BDT} * \$30 * 10\% [\text{acceptance}] * 0.92 [\text{deduction offset}] * 1.25 [\text{fiscal conversion}] = \$690,000$ , rounded = \$1M).

#### BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 1641  
As Introduced March 4, 1999

AMENDMENT 1

On page 2, line 22, strikeout "subdivision (a)" and insert:

subdivision (a), based upon records and other information submitted by the taxpayer to the department.